Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Federal-State Joint Board on	)	CC Docket No. 96-45
Universal Service	)	
	)	
Joint Board Request for Comment on	)	
Certain of the Commission's Rules Relating to	)	
High-Cost Universal Service Support	)	

COMMENTS OF
TDS TELECOMMUNICATIONS CORPORATION

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SUMMARY

The Federal-State Joint Board on Universal Service (Joint Board) has sought comment on various proposals to modify the mechanisms used to calculate High-Cost Support for rural local exchange carriers. For the most part, the proposals under consideration would replace established mechanisms that currently function efficiently and effectively to preserve and advance universal service, in accordance with the goals set forth in the Telecommunications Act of 1996, with mechanisms that threaten to undermine the statutory goals. Rather than investing limited regulatory resources to make risky changes to aspects of the Universal Service Fund that are functioning well, the Commission and Joint Board instead should focus their efforts on correcting the distortions that have resulted in the recent unsustainable growth of the Fund.

The existing High-Cost Support mechanism – under which rural telephone companies, as defined in the Communications Act, recover their study area average embedded costs of providing supported services – is working well to preserve and advance universal service in rural communities. Except where the current cap on High-Cost Loop support results in insufficient cost recovery, the embedded cost mechanism provides rural carriers with sufficient support to provide high-quality telecommunications services to rural subscribers at affordable rates. The embedded cost approach also ensures that any network and corporate operating efficiencies that reduce rural carriers' costs are passed through to the Fund. Conversely, the complexity (indeed, impossibility) of developing a forward-looking proxy model that accurately predicts costs for rural carriers means that any attempt to move from the existing embedded cost mechanism to a forward-looking cost model is likely to undermine, rather than promote, the statutory goal of preserving and advancing universal service. Given this risk, there is no reason

for the Commission to undertake the administratively burdensome task of transitioning hundreds of small, rural telephone companies to a complex and entirely unproven new support mechanism.

There is likewise no indication that modifying the definition of "rural telephone company" or averaging holding company costs at a statewide level will give better effect to the statutory universal service goals than the current approach. These proposals appear to be "back-door" attempts to control the growth of the Universal Service Fund. But the Fund size should not be reduced at the expense of its very purpose. Instead, efforts to control the size of the Fund should be targeted to reduce the outflow of payments that fail to advance the goal of universal service. Thus, the Commission should focus on adopting measures that limit the payment of support from the Fund (1) to carriers that are fully qualified and committed to provide universal service in rural areas and (2) to amounts that are reasonably related to those carriers' embedded costs of providing service.

Consistent with the foregoing, the one area in which adjustments to the basis of support *are* appropriate concerns High-Cost Support paid to competitive eligible telecommunications carriers (CETCs). These carriers currently recover support based on the embedded costs of the incumbent ETC, even though there has been no determination that the CETC's costs approximate those of the ILEC or that recovery based on the ILEC's costs is the most appropriate means "to preserve and advance universal service" in the markets served by CETCs. The Commission should take steps to develop a cost recovery mechanism (or mechanisms) for those carriers, both wireline and wireless, that reflects the competitive ETCs' actual costs in providing supported services.

TABLE OF CONTENTS

Before the
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In the Matter of	)	
	)	
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Universal Service	)	
	)	
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TDS Telecommunications Corp. (TDS Telecom)[1] submits these comments to urge the Federal-State Joint Board on Universal Service (Joint Board) to preserve the embedded cost mechanism currently used to calculate rural incumbent local exchange carriers' (RLECs') costs for purposes of recovering from the Universal Service High-Cost Support Fund.[2] Although the Commission has previously stated its intention ultimately to use forward-looking economic costs to determine rural carriers' High-Cost Support, the fact remains that the existing embedded cost mechanism continues efficiently and effectively to serve the universal service goals of the Telecommunications Act of 1996 (1996 Act). Conversely, no progress has been made in developing – and there is no evidence that it would be possible to develop – a workable, forward-

[1] TDS Telecom is the parent company of 112 incumbent local exchange carrier (ILEC) subsidiaries serving over 700,000 local access lines in small and rural communities. The TDS ILECs take very seriously their commitment to provide high-quality telecommunications services at affordable rates throughout their service areas. Indeed, in respected third-party surveys subscribers have rated TDS Telecom at levels higher than customers of almost every other telephone company on all dimensions, from overall satisfaction to friendliness of employees to reliability of service. But the ability of the TDS ILECs to provide this level of service to their rural customers depends in most cases on the TDS ILECs' receiving substantial support from the Universal Service Fund. Accordingly, TDS Telecom has a strong interest in ensuring that the Fund remains viable and is administered in accordance with the underlying statute for the purposes Congress intended.

[2] These comments are submitted in response to the Public Notice, *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, CC Docket No. 96-45 (rel. Aug. 16, 2004) (*Notice*), which was issued in response to a referral order released by the Commission in June 2004. Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 04-125 (rel. June 28, 2004) (*Referral Order*).

looking rural cost model that would be "specific, predictable, and sufficient . . . to preserve and advance universal service" in rural, insular, and high-cost areas. Accordingly, any attempt to move from the existing embedded cost mechanism to a forward-looking proxy model is likely to undermine, rather than advance, the statutory provisions the Commission is charged to uphold. Given this risk, there is no reason for the Commission to undertake the administratively burdensome task of transitioning hundreds of small, rural telephone companies to a complex and entirely unproven new support mechanism.

The one area in which adjustments to the basis of support *are* appropriate concerns High-Cost Support paid to competitive eligible telecommunications carriers (CETCs). These carriers currently recover support based on the embedded costs of the incumbent ETC, even though there has been no determination that the CETC's costs approximate those of the ILEC or that recovery based on the ILEC's costs is the most appropriate means "to preserve and advance universal service" in the markets served by CETCs. TDS Telecom encourages the Joint Board to consider adopting an alternative high-cost support mechanism (or mechanisms) for CETCs, both wireline and wireless, that reflects the CETCs' actual costs in providing supported services.

I. THE RURAL HIGH-COST SUPPORT MECHANISM MUST ADVANCE THE UNIVERSAL SERVICE PRINCIPLES SET FORTH IN THE 1996 ACT

Although the Commission determined in the *Universal Service First Report and Order* that universal service support generally should be based on forward-looking costs,[3] the Joint Board cannot pursue that aspiration blindly. Any decision concerning the High-Cost

[3] *See* Report and Order, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, 12 FCC Rcd 8776, 8899 (1997) (subsequent history omitted).

Support mechanism for rural carriers must first and foremost be guided by – and consistent with – the universal service principles set forth by Congress in the 1996 Act. These are:

(1) Quality and rates: Quality services should be available at just, reasonable, and affordable rates.

(2) Access to advanced services: Access to advanced telecommunications and information services should be provided in all regions of the Nation.

(3) Access in rural and high cost areas: Consumers in all regions of the Nation, including low-income consumers and those in rural, insular, and high cost areas, should have access to telecommunications and information services, including interexchange services and advanced telecommunications and information services, that are reasonably comparable to those services provided in urban areas and that are available at rates that are reasonably comparable to rates charged for similar services in urban areas.

(4) Equitable and nondiscriminatory contributions: All providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service.

(5) Specific and predictable support mechanisms: There should be specific, predictable and sufficient Federal and State mechanisms to preserve and advance universal service.

(6) Access to advanced telecommunications services for schools, health care, and libraries: Elementary and secondary schools and classrooms, health care providers, and libraries should have access to advanced telecommunications services as described in [section 254(h)].

(7) Additional principles: Such other principles as the Joint Board and the Commission determine are necessary and appropriate for the protection of the public interest, convenience, and necessity and are consistent with this chapter.[4]

These principles reflect an overriding goal of ensuring that support mechanisms are adequate to promote access for all Americans to an evolving level of telecommunications services, including advanced services. This goal must remain paramount as the Joint Board considers possible changes to the cost basis and method of calculating High-Cost Support for rural carriers.

[4] 47 U.S.C. § 254(b).

II. THE EXISTING EMBEDDED COST MECHANISM REMAINS THE APPROPRIATE MECHANISM TO ADVANCE THE STATUTORY GOAL OF PRESERVING AND ADVANCING UNIVERSAL SERVICE IN RURAL AREAS

The embedded cost mechanism currently used to calculate High-Cost Support for rural carriers has functioned effectively since its inception and, consistent with Section 254, has promoted universal access to telecommunications services, including advanced services, in rural communities. Equally important, the past three years have yielded no new evidence to suggest that a forward-looking cost model could be developed that would similarly advance the statutory universal service goals. Indeed, non-rural carriers have asserted that the forward-looking cost mechanism applied to them provides insufficient recovery of the costs of serving rural areas. Although non-rural carriers generally can absorb this deficiency because of their broader subscriber bases, additional revenue sources, and relatively limited reliance on universal service funding, rural carriers lack that foundation and thus they – and their subscribers – cannot bear the same risk.

A. The Embedded Cost Mechanism Provides Specific, Predictable, and Sufficient Support to Preserve and Advance Universal Service

The rural High-Cost Support mechanism has functioned effectively since its inception to bring telephone service to a growing percentage of American households, especially in rural areas. The Commission's *Telephone Subscribership Report* shows that, despite a small dip in the past year or so (likely attributable to general economic factors), telephone subscribership rates in the United States have increased steadily over the past two decades, growing from 91.4% in 1983 to 94.2% in 2004.[5] For the most part, the most significant

[5] *Telephone Subscribership in the United States (Data Through March 2004)*, Industry Analysis and Technology Division, Wireline Competition Bureau, FCC, at 6 (rel. August 2004) (*2004 Telephone Subscribership Report*). Over the past five years, subscribership rates at times have been as high as 95.5%. *Id.*

increases in subscribership rates have occurred in states with large rural areas. As compared to a nationwide increase of 2.8% between 1983 and 2004, telephone penetration rates increased by 12.4% each in Alaska and South Carolina, by 9.2% in Mississippi, by 8.2% in Florida, by 7.3% in Idaho, and by between 5% and 7% in the states of Maine, New Mexico, Tennessee, Utah, West Virginia, and Wyoming.[6] Likewise, rates for telecommunications services in rural areas have remained affordable and generally comparable to those paid by consumers in urban areas.[7]

The Commission's Section 706 reports show that the existing embedded cost mechanism has contributed to the general financial health of rural carriers and thereby enabled those carriers to invest in deploying advanced services in rural communities.[8] In the most recent Section 706 Report, the Commission found that "the deployment of advanced services capability has increased in rural areas" since the Commission's 2002 report, with high speed Internet service available in 73% of the lowest density zip codes in December 2003 (as opposed to 37% in June 2001).[9] Based on this and other broadband deployment statistics, the Report concluded

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[6] *Id.* at 8.

[7] Although local telephone service rates vary from state to state and area to area, so that determining a "typical" rural rate is very difficult, *see Universal Service Monitoring Report 2004*, CC Docket No. 98-202, CC Docket No. 96-45, at 7-3 (Oct. 2004) (*2004 USF Monitoring Report*), it is TDS Telecom's experience that state regulators work very hard to ensure that local service rates in rural areas are not significantly higher than urban rates.

[8] Broadband deployment to all Americans, including those in rural areas, is recognized as a critical goal not only in the 1996 Act, but by national policymakers from legislators to regulators to presidential candidates. *See, e.g.,* Anne Marie Squeo, "Election Pledge: Broadband Access for All," *Wall Street Journal*, Sept. 14, 2004, at A4; Ann Grimes, "Closing the Gap," *Wall Street Journal*, Oct. 29, 2001, at R14; Cong. Rec. S5768 (June 17, 2002) (Statement of Sen. Johnson); Michael Powell, "Rural Lands of Opportunity: Broadband Deployment in America's Heartland," remarks delivered at the Kansas Rural Broadband and Telemedicine Summit (Feb. 20, 2004).

[9] Fourth Report to Congress, *Availability of Advanced Telecommunications Capability in the United States*, GN Docket No. 04-54, FCC 04-208, at 30 (rel. Sept. 9, 2004) (*Fourth Section 706 Report*). Section 706 of the 1996 Act calls on the Commission and state regulators to "encourage the deployment on a reasonable and timely basis of advanced telecommunications capability to all Americans (including, in particular, elementary and secondary schools and classrooms) by utilizing, in a manner consistent with the public interest, convenience, and necessity, price cap regulation, regulatory forbearance, measures that promote competition in the local telecommunications market, or other regulating methods that remove barriers to infrastructure investment." Section 706 also requires Congress to conduct regular inquiries concerning whether advanced telecommunications capabilities are being deployed to all Americans in a reasonable and timely manner and, if not, to take action to encourage such deployment. Telecommunications Act of 1996, P.L. No. 104-104, § 706, 101 Stat. 154.

that "the overall goal of section 706 is being met, and that advanced telecommunications capability is indeed being deployed on a reasonable and timely basis to all Americans."[10] The embedded cost mechanism has played an important, albeit indirect, role in making this result possible. Although universal service funding today does not directly reimburse the costs of deploying broadband services, the embedded cost mechanism provides carriers with the assurance that they will adequately recover their costs of providing supported services. It is the certainty of this recovery that allows rural carriers to invest in network upgrades that facilitate the deployment of advanced services to rural subscribers.[11]

As the thoughtful and comprehensive Rural Task Force Working Papers explain, the embedded cost mechanism succeeds because it is grounded in the real-world costs of serving rural customers. Apart from actual measurement, these costs are extremely difficult to predict or project because of the immense variations in the geographic, economic, and regulatory conditions among and within rural study areas.[12] Because the embedded cost mechanism by its nature captures every factor affecting each individual carrier's costs of providing supported services, it has proven to be the most effective means to ensure that rural High-Cost Support remains sufficient to preserve and advance universal service in rural areas.[13]

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[10] *Fourth Section 706 Report* at 8.

[11] Of course, more could be done from a universal service perspective to speed the deployment of advanced services to rural consumers, including adding broadband capability to the definition of universal service and providing support for specific rural upgrades designed to deploy broadband service. The Commission should remain open to this possibility as it pursues policies to promote nationwide broadband deployment and usage, although in the early stages it would be prohibitively expensive for the Commission to mandate universal access to broadband capability or high-speed Internet access. *See Ex Parte* Letter from Margot Smiley Humphrey, Counsel to TDS Telecom, to William F. Caton, Acting Secretary, FCC, CC Docket No. 96-45, Attachment (Feb. 14, 2002).

[12] *See Rural Task Force White Paper #2: The Rural Difference* 29 (2000) (available at http://www.wutc.wa.gov/rtf) (*RTF White Paper #2*).

[13] *See Rural Task Force White Paper #3: Alternative Mechanisms for Sizing a Universal Service Fund for Rural Telephone Companies* 10-11 (2000) (available at http://www.wutc.wa.gov/rtf) (*RTF White Paper #3*).

Moreover, there is no evidence that rural carriers are operating their networks inefficiently under the embedded cost mechanism. High-Cost Support does not cover all rural carrier costs. This alone provides carriers with a strong incentive to control those costs. In addition, the competitive business and investment climate in which all telecommunications carriers operate ensures that rural carriers have sufficient economic incentives to control costs and pursue efficient operations.

B. Basing Rural High-Cost Support on Forward-Looking Economic Costs would Undermine the Goals of Universal Service

In contrast to the successes of the embedded cost mechanism, attempting to convert to a forward-looking cost model to calculate rural High-Cost Support would impose unacceptable risks to the future of universal service in rural America. The Rural Task Force White Papers explained in detail the complexity involved in attempting to develop a forward-looking proxy model that would meet the statutory requirement of providing "specific, predictable, and sufficient" support, across a range of rural carriers operating in diverse geographic, economic, and regulatory circumstances, to preserve and advance universal service throughout the United States.[14] Because of the diverse circumstances in which rural carriers operate, the Rural Task Force could reach no agreement on the appropriate inputs for a rural forward-looking proxy model.[15] At the same time, the Rural Task Force demonstrated that even small changes in inputs can produce large variations in the level of support.[16] Based on these

[14] *See Rural Task Force White Paper #4: A Review of the FCC's Non-Rural Universal Service Fund Method and the Synthesis Model for Rural Telephone Companies* (2000) (available at http://www.wutc.wa.gov/rtf) *(RTF White Paper #4).*

[15] *See RTF White Paper #3* at 23.

[16] *See id.*.

factors, the Rural Task Force concluded that basing rural high-cost recovery on a forward-looking cost model was not feasible.

The Commission acknowledged the Rural Task Force's concerns in the *Rural Task Force Order* and admitted that there was insufficient information available at that time to construct a workable forward-looking cost model for rural carriers.[17] The passage of time since the *Rural Task Force Order* was released has not changed that situation. The circumstances cited by the Rural Task Force in 2000 remain fully applicable today: rural carriers operate in diverse geographic, economic, and regulatory circumstances; the appropriate inputs for a rural forward-looking cost model are not apparent; and small changes in inputs would yield significant variation in the level of support recovered by rural carriers. In short, there is no more evidence today than in 2001 that a workable forward-looking cost model could be developed that would ensure "specific, predictable, and sufficient" support for rural carriers.

While the likelihood of adopting the right forward-looking rural cost model is slim, the risk of adopting the wrong model is great.[18] If the Joint Board were to recommend, and the Commission to adopt, a forward-looking rural cost model that provided insufficient cost recovery to rural carriers, rural consumers would suffer a significant decline in the availability

[17] *See* Fourteenth Report and Order, Twenty-Second Order on Reconsideration, and Further Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, and Report and Order, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, 16 FCC Rcd 11,244, 11,313 (2001), as corrected by Errata, CC Docket Nos. 96-45, 00-256 (Acc. Pol. Div. rel. June 1, 2001) (*Rural Task Force Order*).

[18] For example, non-rural carriers have argued that the non-rural forward-looking cost model yields inadequate high-cost support for serving rural areas. *See, e.g., Texas Ofc. of Public Utility Counsel v. F.C.C.*, 183 F.3d 393, 410-11 (5th Cir. 1999). (We recognize that courts have held that the model is not so deficient as to rise to the level of a constitutional taking, *id.* at 413 n.14, but that does not prove that the model provides adequate support to advance the statutory universal service goals.) Deficiencies in the non-rural cost model have not been disastrous for non-rural carriers, however, because the non-rural carriers have sufficient alternative revenue sources and non-rural customers to absorb the deficiencies. (Even so, larger rural carriers have been divesting themselves of rural lines. *See, e.g.,* Frank Gallagher, RBOC's Loss Could be Rural ILECs' Gain, *Rural Telecommunications*, July 1, 2003, at 10; Victor Glass, Sale of Rural RBOC Lines Pick Up Speed, *Rural Telecommunications*, January 1, 2002, at 5255.) Rural carriers are not similarly equipped to absorb deficiencies resulting from an inadequate forward-looking cost model.

and quality of telecommunications services. First, rural carriers' operating revenues would suffer dramatic swings as a result of the inevitable inaccuracies in a forward-looking model. Many rural carriers derive a significant portion of their revenues from universal service support payments and recover a relatively smaller share of revenue from subscriber charges for lower-cost access lines.[19] Moreover, rural carriers have higher costs and narrower customer and revenue bases than non-rural carriers.[20] This leaves them extremely vulnerable to a misguided or inadvertent reduction in High-Cost Support, which would significantly undermine the carriers' ability to serve their rural subscribers as envisioned by the 1996 Act.[21]

A forward-looking cost model also would serve as a *disincentive* to investment in the facilities needed to deploy advanced services in rural areas. Under a forward-looking model, carriers would recover the same support regardless of whether they invested in upgrading their networks or not. This contrasts sharply to the embedded cost mechanism, under which rural carriers are assured of reimbursement (within the existing cap) for investment in upgrading facilities used to provide supported services. Similarly, the embedded cost model provides carriers with certainty that they will recover a predictable portion of the costs of providing supported services from universal service, which allows carriers to make informed decisions to invest capital in upgrades necessary to deploy advanced services. In the absence of such certainty, rural carriers would lack both the wherewithal and the incentive to invest in the

[19] *See RTF White Paper #4 at 8.*

[20] *See RTF White Paper #2* at 30-57.

[21] Given the current concerns about the size of the Fund, TDS Telecom expects that inaccuracies in a forward-looking proxy model would err on the side of under-recovery of support for rural carriers. To the extent that errors in the forward-looking cost model resulted in over-recovery, the model would accelerate growth of the Fund. Requiring rural carriers to avoid this problem by calculating costs on both a forward-looking and embedded cost basis and limiting recovery to the lesser of the two would add an additional administrative burden on rural carriers that would divert resources from serving rural consumers.

provision of advanced services.[22] Carriers would likely defer or avoid necessary upgrades, resulting in the deterioration of existing facilities rather than the deployment of advanced services. As a result, service offerings and quality could well fall behind those available to urban consumers, directly contravening the dictates of Section 254.[23]

C. The Administrative Burdens of Moving to a Forward-Looking Cost Mechanism Would be Substantial and Unjustified

As described above, the existing embedded cost mechanism operates successfully, and the risk of harm to rural communities from the adoption of an inadequate forward-looking rural cost model is significant. Under these circumstances, it would be an unwise expenditure of limited regulatory resources for the Commission and Joint Board to attempt to develop and transition rural carriers to a forward-looking cost mechanism for High-Cost Support.

The administrative burdens involved in such an undertaking would be massive. The complexity in identifying the appropriate inputs for a rural forward-looking proxy model were well documented by the Rural Task Force. In addition to the model itself, the Commission would need to develop appropriate safety valves and transition mechanisms to smooth the

[22] Competitive pressures could provide some incentive for rural carriers to upgrade their facilities, but relying on competition is not a complete solution. Many very high-cost areas are not subject to direct, wireline competition, and in other areas in which carriers would like to upgrade their networks in response to competitive pressures, the economies of scale still may not justify the required investment in the absence of certainty in the recovery of universal service funding for supported services.

[23] In fact, there is a risk that the goals of Section 254 will erode even under the existing mechanism due to the continued application of the cap on High-Cost Loop (HCL) support. The effect of the cap is to reduce the proportion of RLEC costs that are recoverable from the Fund. As a result, rural carriers find themselves with fewer resources to dedicate to network upgrades and the deployment of advanced services. The long-term effects of continuing to cap RLEC support at levels below the carriers' embedded costs parallel the risks of converting to a forward-looking cost mechanism: insufficient and uncertain recovery of costs, reduced investment in network maintenance and upgrades, and declining service quality and potentially increasing costs for rural subscribers. Because the continued application of the cap on HCL support threatens to roll back the successes experienced under the embedded cost mechanism, the Joint Board should recommend not only that the Commission maintain the embedded cost mechanism but that it eliminate the cap on HCL support. This step is necessary to continue to advance the goals of Section 254, and overall should not result in excessive growth of the Fund if, in conjunction with lifting the cap, the Commission adopts stricter criteria for ETC designation and a cost-based recovery mechanism for CETCs.

transition to an inevitably imperfect cost recovery mechanism. At the state level, regulators would need to reevaluate RLEC rates to take into account the universal service shortfalls likely to result from adoption of a forward-looking cost model. Finally, rural carriers themselves would need to expend significant resources learning about and applying the new cost model, evaluating the impact of the new cost model on their operating revenues, and adjusting rates, services, and investment plans in light of that impact. Taking on (or imposing) these administrative burdens is simply unnecessary given that the existing embedded cost model functions effectively and has succeeded in promoting the statutory goals.

III. COMPETITIVE ELIGIBLE TELECOMMUNICATIONS CARRIERS, LIKE RURAL INCUMBENTS, SHOULD RECOVER HIGH-COST SUPPORT BASED ON COST RECOVERY MECHANISMS THAT REASONABLY REFLECT THEIR ACTUAL COSTS INCURRED IN PROVIDING SUPPORTED SERVICES

The one area in which modification of the High-Cost Support recovery mechanism *is* appropriate concerns the one category of providers for whom recovered costs are not in touch with reality: competitive ETCs. Competitive eligible telecommunications carriers have been recovering support from the Universal Service Fund based not on their costs, nor on some forward-looking proxy, but on the ILECs' embedded costs of providing supported services. Section 254 requires that universal service support be "specific, predictable, and sufficient." Support that is either insufficient or excessive is inconsistent with these statutory principles. With respect to rural and non-rural carriers serving rural areas, the Commission has invested significant time and resources in determining the appropriate basis upon which to calculate "sufficient" support that provides "appropriate incentives for investment, entry, and innovation in the marketplace."[24] No such efforts have been made with respect to competitive ETCs.

[24] *Notice* ¶ 20.

Instead, CETCs have been allowed to recover High-Cost Support based on the ILEC's embedded per-line costs without any finding either that the CETC's costs approximate those of the ILEC or that, for other reasons, permitting the CETC to recover support based on the ILEC's embedded costs affords "sufficient" support to preserve and advance universal service in the rural market.

As the Commission evaluates options in other proceedings to control the size of the Universal Service Fund,[25] the time has come for the Commission to revisit the basis of support paid to competitive ETCs. As TDS Telecom explained in our comments on the *ETC/High-Cost Notice*, the Commission can both promote the long-term sustainability of the Universal Service Fund and give effect to Section 254 of the Communications Act by limiting the payment of High-Cost Support to carriers that satisfy strict criteria for providing truly universal service in the designated service area *and* by ensuring that those carriers recover support that is reasonably related to their costs of providing supported services.[26]

TDS Telecom is not in a position to know the appropriate mechanism for calculating support for CETCs. We acknowledge that the process of determining the appropriate mechanism will be administratively complicated, just as it is – and has been – for incumbent carriers. With respect to CETCs, however, it is now time to undertake that task because (1) no effort has previously been made to determine the appropriate basis for CETC recovery of High-Cost Support, (2) it is economically irrational and potentially excessive to permit CETCs to continue to recover support based on the ILEC's costs, given that the costs actually incurred by

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[25] *See* Notice of Proposed Rulemaking, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 04-127 (rel. June 8, 2004) (*ETC/High-Cost Notice*) (seeking comment on Recommended Decision, *Federal-State Joint Board on Universal Service Seeks Comment on Certain of The Commission's Rules Relating to High-Cost Universal Support and The ETC Designation Process*, CC Docket No. 96-45, FCC 04J-1 (rel. Feb. 27, 2004) (*ETC/High-Cost Recommended Decision*)).

[26] *See* Comments of TDS Telecommunications Corp., CC Docket No. 96-45, at 3-4 (filed Aug. 6, 2004).

the CETC – which often provides service using a different network – may differ dramatically from those of the incumbent, and (3) developing an appropriate basis of support will give effect to the requirements of Section 254 rather than undermine them. Accordingly, TDS Telecom urges the Joint Board and the Commission to take the opportunity in this proceeding to develop an appropriate high-cost support mechanism (or mechanisms) for competitive ETCs, both wireline and wireless. This mechanism should ensure that CETCs recover support that reasonably reflects the CETC's actual costs incurred in providing supported services and is no more than necessary to preserve and advance universal service.

IV. THE COMMISSION SHOULD CONTINUE TO USE THE STATUTORY DEFINITION OF "RURAL TELEPHONE COMPANY" AND SHOULD CONTINUE TO CALCULATE HIGH-COST SUPPORT AT THE STUDY AREA LEVEL

As described above, the existing methodology for calculating High-Cost Support for rural carriers is working well to preserve and advance universal service in rural areas in accordance with the principles set forth in Section 254 of the Act. Moreover, the payment of High-Cost Support to rural carriers under this methodology has not been the primary cause of the recent surge in the size of the Universal Service Fund.[27] Accordingly, modifications to the current approach should be avoided in the absence of strong evidence that the goals of Section 254 would be accomplished more effectively through the proposed modification. No such evidence exists to support changing either (1) the current definition of "rural telephone company" for universal service purposes or (2) the current methodology of calculating support at the study area level.

[27] *See, e.g.*, *2004 USF Monitoring Report* at 3-15 (Table 3.2). The *Monitoring Report* shows a significantly higher growth rate for CLECs' recovery of High-Cost Support than for ILECs' during the period from 1999 to 2004. While High-Cost Support paid to CLECs has increased annually by triple-digit percentages for most of this period, ILEC recovery has remained relatively flat except for the 2000-2001 period during which implicit access charge subsidies were transitioned to explicit universal service support under the MAG access charge reform plan.

A. There Is No Reason to Depart from the Statutory Definition of "Rural Telephone Company" for Universal Service Purposes

Section 3(37) of the Act defines a "rural telephone company" as a LEC that:

> (A) provides common carrier service to any local exchange carrier study area that does not include either—
>
> (i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or
>
> (ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;
>
> (B) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;
>
> (C) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or
>
> (D) has less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996.[28]

This definition applies throughout the Act (unless the context otherwise requires).[29]

Although the term "rural telephone company" is not used in the principles set forth in Section 254, and the statutory definition of "rural telephone company" thus is not *expressly* incorporated into the principles governing the administration of universal service support mechanisms, the term is used in other sections of the Act relating to universal service. For example, Section 214(e), relating to designation of ETCs, requires regulators to apply a different standard when considering designating an additional ETC in an area served by a "rural telephone company" than in areas served by non-rural carriers.[30] Section 214(e) also mentions "rural telephone companies" in defining the "service areas" within which ETCs may be

[28] 47 U.S.C. § 153(37).

[29] 47 U.S.C. § 153.

[30] 47 U.S.C. § 214(e)(2).

designated as "a geographic area established . . . for the purpose of determining universal service obligations *and support mechanisms*. In the case of an area served by a rural telephone company, 'service area' means such company's 'study area' unless and until the Commission and the States, after taking into account recommendations of a Federal-State Joint Board . . . , establish a different definition of service area for such company."[31] These provisions reflect a congressional understanding that the concept of a "rural telephone company," *as defined by Congress*, would play a role in regulatory decisions concerning eligibility for – and mechanisms for recovery of – universal service support.[32]

There is no persuasive reason to depart from the statutory definition – and congressional intent – at this time.[33] As described above, the current mechanism of providing support to "rural telephone companies," as defined in the Act, on the basis of embedded costs appears to be working well. There is no widespread evidence that a meaningful number of carriers classified as rural telephone companies under the Act lack the characteristics that justify treatment under the rural cost recovery mechanism or otherwise recover unjustified levels of support due to their classification as rural carriers.[34] In the absence of any evidence that the statutory definition of "rural telephone company" is undermining the pursuit of the universal

[31] 47 U.S.C. § 214(e)(5) (emphasis added).

[32] The Joint Board appears to have assumed as much in its decision "recommending" that the statutory definition of "rural telephone company" be used in administering High-Cost Support. In recommending that a bifurcated system (distinguishing non-rural from rural carriers) be used in determining High-Cost Support, the Joint Board adopted without discussion the statutory definition of "rural telephone company" to make the distinction between carriers. Recommended Decision, *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, FCC 96J-3, 12 FCC Rcd 87, 236 [¶ 287] (1996). *See also id.* at 216 [¶ 242] ("Most parties agree that, if a bifurcated system is used, the Commission should apply the 1996 Act's definition of 'rural telephone company' to determine which telephone companies would continue to draw universal service based on their book costs.").

[33] *See Notice* ¶ 8 (seeking comment on whether the Commission should consider modifying the definition of "rural telephone company" for purposes of the universal service support mechanisms).

[34] USAC statistics indicate that the vast majority of high-cost support is received by ILEC study areas with fewer than 100,000 access lines. *See* Universal Service Administrative Company, *Federal Universal Service Fund Size Projections for the Fourth Quarter 2004*, App. HC01, HC05, HC18 (Aug. 2, 2004).

service goals identified by Congress, there is no need for the Joint Board and Commission to attempt to create an alternative definition that could undermine congressional intent and would inevitably complicate the administration of the universal service system (by requiring, for example, a recalculation of the nationwide average costs used to determine support).

B. Calculating Support at the Study Area Level Remains Appropriate

The Joint Board seeks comment on whether the Commission should consider changing the current method of calculating High-Cost Support for rural carriers at the study area level. For example, the Joint Board asks whether the Commission should consider calculating support based on statewide average costs or wire center costs rather than average study area costs.[35] As with the definition of "rural telephone company," there is no persuasive evidence that the current method for calculating support is not providing "specific, predictable, and sufficient" support to "preserve and advance universal service" or that any of the proposals advanced in the *Notice* would more effectively accomplish that goal. Accordingly, the Commission should continue to calculate rural high-cost support at the study area level.

Most RLEC study areas correspond to the area in which the particular LEC operating company provides service. In many cases this study area encompasses the entire geographic area served by the LEC in the state, but in some cases a LEC (or multiple LECs owned by a single holding company) will have more than one study area within a single state. These study areas typically are used both to determine universal service support and for intrastate ratemaking purposes.

When a holding company operates multiple LEC subsidiaries in multiple study areas in a state, the decision to do so is driven by geographic separation between study areas and

[35] *Notice* ¶¶ 38-45.

other sound business reasons. The subsidiaries are operated as separate companies with largely separate facilities and separate customer service and technical personnel. In TDS Telecom's case, maintaining separate operating companies serving each study area is consistent with the company's long history of commitment to community. TDS Telecom has brick-and-mortar branch offices in nearly every community we serve, allowing the TDS ILECs to remain accessible and accountable to their customers and local communities.

The geographic and operational distinctions between operating companies or study areas within a single state can result in substantially different cost structures for those companies. Attempting to average those costs across different companies for the purpose of calculating universal service support (and then perhaps to de-average the costs for purposes of distributing the support received among the companies), in addition to being administratively complex, would likely result in significant under-recovery of costs for some companies and over-recovery for others. It would be extremely complicated to attempt to reconcile those discrepancies at the holding company level. The resulting deficiencies and uncertainties in the recovery of the costs of providing supported services likely would, for the reasons described in Part II-B above, lead to a reduction in the quality of supported services and a decline in the deployment of advanced services in rural areas. In short, moving to a system of calculating costs and support at the state level rather than the study area level would undermine rather than advance the goals of universal service.

In addition, requiring rural LECs to consolidate their costs on a statewide basis would require state regulators to reevaluate local rate schedules to reflect changes in the operating companies' universal service support levels. This ratemaking process would be administratively complex and time-consuming for state regulators, particularly in predominantly

rural states with a large number of rural carriers. These rate adjustments are also likely to lead to price increases where statewide averaging reduces a LEC's recovery of universal service support. Such price increases could result in rural local service rates that are higher than those in urban areas, in direct contravention of the statutory goals.

Finally, it is unnecessary for the Commission to alter the method for calculating High-Cost Support to ensure that the efficiencies and economies of scale generated by holding companies are reflected in the universal service support they recover. Because the current embedded cost mechanism bases support on the actual costs incurred by rural carriers, any savings generated when a holding company consolidates corporate functions or achieves economies of scale in purchasing equipment and services already are passed through to the Universal Service Fund through reduced corporate operations and other expenses of the holding company's rural LEC subsidiaries. Independent rural LECs realize some of the same savings – and pass those saving on to the Universal Service Fund under the embedded cost mechanism – by using consultants and buying groups to obtain equipment and services. Accordingly, there is no need for the Commission to consider averaging rural costs on a statewide level as a means to control the growth of the Universal Service Fund.

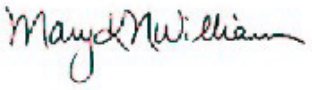
Nor should the Commission require RLECs to calculate costs at the wire center level. Rural carriers have never determined their costs on that basis, and it would be a major administrative undertaking to attempt to do so. Requiring rural carriers to calculate costs on either a statewide or wire center level would require complicated modifications in the way costs are determined as well as extensive state ratemaking proceedings to implement the necessary rate adjustments. Given the successful operation of the current mechanism, such endeavors are entirely unnecessary.

CONCLUSION

The current mechanism for determining High-Cost Support for rural ILECs is functioning effectively to preserve and advance the goals of universal service. The proposals advanced by the Joint Board for modifying the mechanism, on the other hand, are more likely to undermine than advance the statutory universal service principles. The only area in which modification of the existing cost recovery mechanisms is justified concerns the recovery of support by competitive ETCs. The Commission should take steps to develop a cost recovery mechanism for those carriers that reflects the competitive ETCs' actual costs in providing supported services. Adopting and preserving cost recovery mechanisms that base support for each ETC serving a rural area (incumbent or competitor) on *that carrier's* embedded costs (1) will ensure sufficient support to preserve and advance universal service, (2) will allow network and corporate operating efficiencies to be reflected in the amount of support ETCs recover, and (3) in conjunction with measures to limit the payment of support to carriers satisfying strict ETC eligibility criteria, will contain the growth of the Universal Service Fund by preventing over-recovery of support.

Respectfully submitted,

TDS TELECOMMUNICATIONS CORP.



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